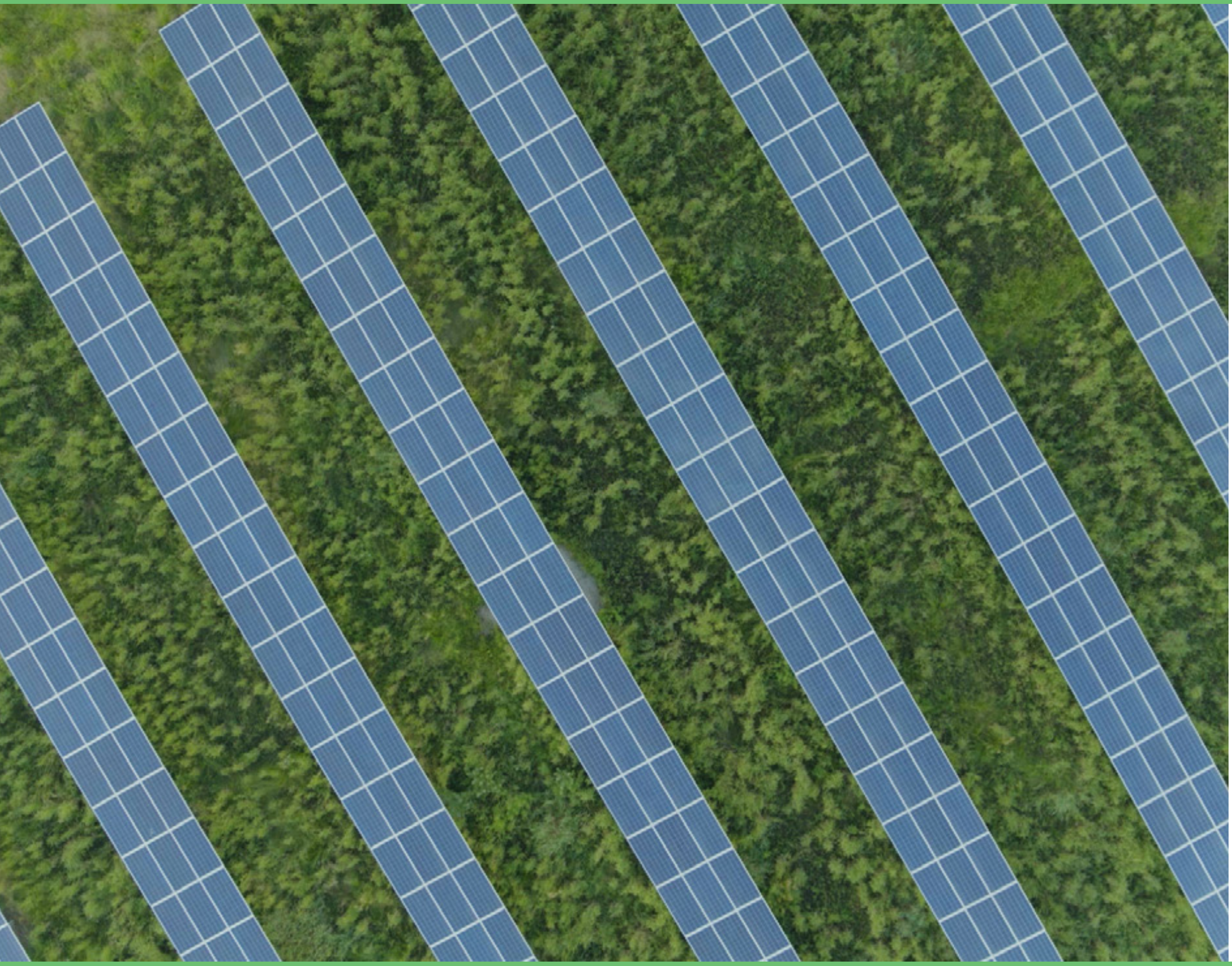

How to Align Your Stakeholders: A guide for creating your renewable energy purchasing team

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Green Power

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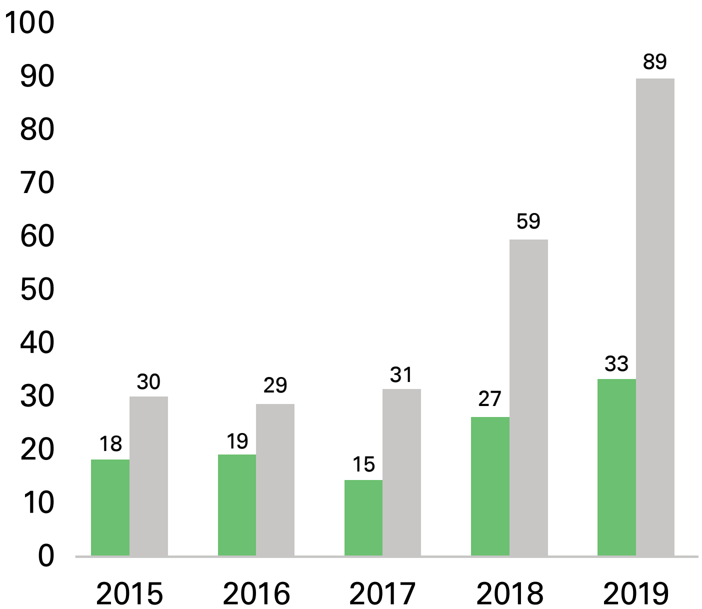
Getting started with a VPPA

In most of life's great adventures, the first time is the hardest. Executing your first virtual power purchase agreement (VPPA) is no exception. But, what's the most common reason that companies sometimes struggle to complete their first VPPA? It's because they don't build and nurture the right internal team to execute the transaction.

The need to get the first virtual power purchase agreement right is more acute than ever. The total number of corporate VPPA agreements reached an all-time high in 2019, with 89 transactions completed (Figure 1). Thirty-three of those transactions – 37% – were enterprises executing their first VPPA ever.

Figure 1: Corporate VPPA Transactions



Source: Bloomberg New Energy Finance

Despite the impact of COVID-19 this year, Bloomberg's data shows that 16 corporations had reported executing their first VPPA by the end of October 2020. (There's usually some delay in transactions being recorded; it's likely there will be roughly 25 first time buyers in total in 2020.)

VPPAs bring powerful benefits to help corporations achieve their sustainability goals, including support for climate action and greenhouse gas (GHG) emission reduction. But VPPAs are sophisticated and although more than 320 VPPAs have been executed in the US alone, they are still a new form of transaction for many executives. Typically, each transaction is valued at tens of millions of dollars. So, coupled with the tremendous sustainability benefits of a VPPA, it is a significant financial risk that needs to be understood and managed. Lacking experience in this area, some organizations enlist the help of an independent broker, consultant, or advisor to help them navigate their first VPPA successfully. That can be helpful – but the buyer still needs to organize its internal team.

Whether or not a third party is enlisted to help, there are four key steps a company can take to ensure their first virtual power purchase agreement is executed successfully. These steps help to de-risk the transaction, ensure it is completed on time, and – perhaps most importantly – comes with no unpleasant surprises. The four steps are:

1. Ensure that your renewable energy strategy is aligned with your sustainability strategy – and consider how renewable energy sourcing can support advancing your Environmental, Social and Governance (ESG) objectives.

2. Have all the right people on the team. The team you need to execute a VPPA successfully is quite diverse, embracing a broad range of skills and expertise. The remainder of this guide will expand on who is needed and what they will need to do.

3. Form the team early. Working towards a VPPA is a new experience for many corporate executives. The team members will need plenty of time to understand the contract structure, get comfortable with it, understand and fulfill the demands of their role.

4. Overcommunicate, because it's a new experience for many people.

Enel Green Power's High Lonesome Wind Farm, where Danone North America is a partner.

The team members

Successfully executing your first (and subsequent) VPPA requires a diverse set of skills, delivered by a diverse team. Here are the business functions you need to have on the team:

- Sustainability. Not all companies have someone with the official title of Chief Sustainability Officer (CSO) yet. That's OK. But the most senior sustainability person in the organization needs to be intimately involved.
- Finance. Ultimately, the most important part of the team, with the broadest list of responsibilities, and the broadest range of skills required. Typically, the go/no go decision sits with the Chief Financial Officer (CFO), because a VPPA is a financial contract, not an energy contract.
- Legal. A VPPA is a long-term contractual commitment with risks that need to be understood so that they can be managed appropriately. The legal team is a key part to understanding, quantifying and mitigating those risks.
- Corporate real estate, Facilities management, or Energy management. Titles vary, but there's a need for someone who can audit and understand the corporation's current and future energy needs.
- Investor relations. Corporate sustainability initiatives can be influenced by stakeholder pressure, and those stakeholders include investors. Formulating a plan to communicate renewable energy sourcing and sustainability achievements to investors is essential.
- Corporate communications. In tandem with investor relations - and often overlooked – the corporate communications team needs to be involved to ensure the corporation makes the most of the sustainability claims. In addition to investors that need to be briefed, other stakeholders that need to be communicated with can include customers, employees and potentially suppliers.

In addition, the Procurement function is sometimes, but not always, involved to help execute the contract. That's because a VPPA is a financial contract, and not a contract for energy.

How does a virtual power purchase agreement work?

A VPPA is a financial contract, also referred to as a contract for differences (CFD). That's because the flow of money from the settlement depends on the difference between a fixed strike price and a variable market price. Here's how it works:

1. The buyer and plant owner agree on a fixed price per megawatt hour (MWh). Say $25 per megawatt hour for this example.

2. The plant owner sells the electricity into the wholesale electricity market as it's generated. That market is open, transparent, and competitive. So, the price received per MWh will vary. During times of high electricity demand, the price received per megawatt hour will be high. When demand is low, the price will drop. Market prices are determined by classic economic supply and demand. Just like the stock market, or real estate.

3. The contract for differences guarantees that the plant owner will always receive $25 per megawatt hour (in this example). So, if the market is only paying $24 per megawatt hour, the buyer owes the plant owner a dollar. Conversely, if the market is paying $26 per megawatt hour, the plant owner owes the buyer a dollar. It's common to include additional restrictions in the contract that limit the amount of financial risk due to price fluctuations.

4. The renewable energy certificates (RECs) associated with the energy produced are transferred to the buyer.

How the team executes a VPPA

Completing a VPPA is a team sport. While the Chief Sustainability Officer (or sustainability function) may act as the quarterback or playmaker, other functions all play a crucial role.

Sustainability

So, why does a corporation pursue a renewable energy contract? A VPPA is one option for companies to balance financial risk and reward, and hedge against future energy costs. In addition, it can be one of the end products of pressure from stakeholders who want to see a more sustainable company. Those stakeholders include investors with an eye on their future returns, consumers and customers who want to support greener brands, and employees who want to work for a company that mirrors their personal values. This stakeholder pressure elicits a high-level C-suite response, which can materialize as a call to action for a sustainability strategy.

Creating an integrated energy strategy is typically the starting point for exploring renewable energy solutions. The World Business Council for Sustainable Development has published guidelines for an integrated energy strategy, providing a useful framework for beginning this work.

Enel Green Power's Roadrunner Solar Farm.

Sheep graze at Enel Green Power's Aurora Solar Farm.

Real Estate, Facilities, and Energy Management

At this point, team members from corporate real estate, facilities management, and/or energy management become involved. The path from a GHG reduction goal to a VPPA is never direct. There is other, low hanging fruit, to be plucked along the way. It's an industry cliché, but it's true: the greenest megawatt hour possible is a megawatt hour that you never have to generate. So, corporations tend to seek out energy efficiencies first and foremost. For those efficiency measures to be completed successfully, real estate and energy management professionals need to play their part. A knowledge of the current and future corporate real estate portfolio, and detailed knowledge of energy consumption and energy costs is required. Armed with this knowledge, the team can focus on delivering efficiency gains, while keeping one eye on the financial return on investment (ROI) of those changes.

Beyond energy efficiency measures, the next step on the Scope 2 reduction journey is often onsite renewables – either wind turbines, solar panels, or battery storage. (Onsite renewables can also help companies reduce Scope 1 emissions in some situations.) However, companies with larger loads, several sites, or limited capital can rarely meet their sustainability goals with onsite renewable energy alone. For those companies, a virtual power purchase agreement is an option that is growing in popularity (see Figure 1).

Finance

At this point, the role of finance becomes pivotal for two reasons. First, many different roles in the finance function need to play a part in delivering this agreement. But more importantly, with a VPPA no energy is purchased. A VPPA is purely a financial arrangement. While the buyer takes ownership of the renewable energy certificates (RECs) associated with the renewable electricity generated, the buyer does not receive the physical electricity. The electricity is sold on the open market on the buyer's behalf. The simplest form of a virtual power purchase agreement is also commonly known as a contract for differences. You can learn more about the benefits of a VPPA contract here.

VPPAs come in many varieties, each slightly different. They all provide RECs, usually include claims to additionality (adding a new renewable energy source to the grid) and include the ability to hedge against future energy costs. But they also include financial risk - a combination of the strike price, market price, and other factors that may be included in the contract. Different flavors of VPPAs provide different balances of risk and reward. The Chief Financial Officer (CFO) needs to understand that risk and find a flavor of VPPA that strikes the right balance between risk and reward for their company, which takes time. VPPAs are a new form of contract for most CFOs, and they are a longer commitment than many other contracts. A ten to twelve-year contract is not uncommon, and longer-term contracts exist too.

Beyond the involvement of the CFO, other finance professionals are also required. For example, given the size of the financial commitment involved, treasury needs to furnish a letter of credit to secure the VPPA contract. Accounting also needs to be involved to ensure that the VPPA contract is correctly recorded in the chart of accounts.

4 guidelines for success

Many companies may not be familiar with virtual power purchase agreements. However, over 320 VPPAs have already been executed in the US alone. There are four keys for the successful execution of a VPPA:

1. Ensure that your renewable energy strategy is tied to your sustainability strategy – typically by focusing on Scope 2 greenhouse gas (GHG) emissions.

2. Take time to ensure you have all the right people in the team. The team you need to execute a VPPA successfully is quite diverse, embracing a broad range of skills and expertise.

3. Form the team early. Working towards a VPPA is a new experience for many team members. Allow plenty of time for people to understand the contract structure, get comfortable with it, understand and fulfill the demands of their role.

4. Over communicate with the team, it's the best way to prevent false assumptions.

Enel Green Power's Rattlesnake Creek Wind Farm.

Agrivoltaics at Enel Green Power's Aurora Solar Farm.

Legal

A virtual power purchase agreement is a substantial legal document, and they need significant legal review. This is by no means an exhaustive list, but some of the key areas that require review include:

- Project description and milestones: Simply put, does the description of the project – name, legal owner, location, technology, installed capacity, milestones, delivery point and so on – match with the description of the renewable energy project that has been discussed and verbally agreed on?

- Credit support: As noted above, credit support is generally required from commercial buyers (also called offtakers). But providing a letter of credit comes at a cost – bank fees must be paid. Likewise, the supplier often provides a similar guarantee against any damages resulting from project delays, or projects being abandoned altogether.

- Term length: Obviously, the contract should reflect the term length discussed. Beyond that, this is a good time to ensure one last time that the term of the VPPA aligns with sustainability goals, future energy usage and the corporate real estate portfolio.

- Pricing terms: The price could be as simple as a price per megawatt hour - but, in practice, it rarely is. Other pricing attributes are often included, to better balance risk and return for both the buyer and the seller. A strong renewable energy project supplier will have the ingenuity, resources, and experience to tailor a VPPA to meet a customer's specific needs.

- Performance guarantees, outages, and force majeure: Contracts usually include protection (in the form of financial penalties) to protect the buyer against underperformance by the supplier. Underperformance may materialize as the asset not generating as much energy as anticipated, or outages for unanticipated maintenance. A definition of force majeure is required, together with the outcomes and consequences.

- Environmental attributes: There are two main environmental attributes to consider with a VPPA. First, renewable energy certificates (RECs), with each REC showing that the buyer owns the claims to a megawatt hour of renewable energy. Second, additionality – evidence that this particular contract has helped to bring a new renewable energy source onto the grid.

- Transfer of ownership: Renewable energy projects can change owners – and sometimes that happens before they have even been constructed. That can be a major concern for a buyer with the uncertainty it introduces – it's a little like having your mortgage sold onto an unknown bank without your consent. Buyers may want to consider including provisions for a change of ownership.

- In addition, given that a VPPA is a derivative, there are credit, registration and reporting criteria that must be satisfied[1].

Investor Relations & Corporate Communications

These two groups have their biggest involvement in the earlier and later phases of executing a VPPA. Corporate sustainability initiatives can be motivated by stakeholder pressures and at for-profit corporations, those stakeholders can include investors. As the Harvard Business Review has noted, institutional investors that weigh environmental, social, and governance (ESG) factors in their investment decisions own roughly 25% of the stock in major corporations. Consequently, formulating a plan to communicate renewable energy sourcing and sustainability gains to investors is essential. It's clearly wonderful to help bring new renewable energy projects online, but communicating that achievement to stakeholders is a powerful motivator for many enterprises. Investor relations and corporate communications groups can work together productively here. Together, they can forge a powerful plan to brief stakeholders on their sustainability plans and renewable energy investments. An experienced renewable energy supplier will be able to help a buyer communicate their sustainability claims appropriately to the widest possible audience.

[1]At the outset, it is required that both parties are considered eligible contract participants and that both the seller and buyer have a registered Legal Entity Identifier code. Once the VPPA is executed, it is also necessary that the contract is reported to the Seller's Swap Data Repository, which is completed by the seller.

In addition to investors, customers, and employees, some companies are encouraging their suppliers to increase their sustainability efforts. Often, this is because the company is looking beyond Scope 1 and 2 greenhouse gas emissions and targeting their Scope 3 emissions too. (Scope 3 emissions are also referred to as value chain emissions; these are the emissions from suppliers that are beyond the direct control of the corporation.) Examples of companies working with their suppliers to reduce Scope 3 emissions include the Walmart Project Gigaton started in 2017, and Anheuser-Busch enabling its suppliers to be more sustainable through the Eclipse initiative. (At Enel Green Power, we also include sustainability as a factor when choosing our suppliers.)

What can go wrong?

Sometimes, despite everyone's best intentions, the VPPA journey is abandoned before the agreement is even signed. That is, something happens during discussions and negotiations that stops – or seriously delays – the process. In Enel Green Power's experience, there are three main reasons why this happens:

1. The Chief Financial Officer isn't engaged early enough or engaged deeply enough. This is the most common reason why a VPPA does not come to fruition. A VPPA is a new type of financial contract for most companies, with risks that need to be understood and mitigated. If the CFO doesn't have enough time to fully understand the structure of a VPPA contract, contemplate the risks, and find the right balance of risk and reward for the company, they are not going to approve the agreement. Even if the CFO doesn't stop the deal outright, the time needed to reset expectations can result in a lengthy delay in achieving sustainability goals.

2. The term sheet is incomplete or ambiguous. A VPPA contract is rich in detail. It is expected that there will be some negotiation on the specifics of the contract terms between the buyer and supplier. But negotiations often go amiss if the term sheet proposed by the buyer is not comprehensive or is open to interpretation. Discussions are extended, and the parties can make different assumptions about ambiguous areas. That can lead to frustration at best, and even create the impression that the other party is not negotiating in good faith.

3. A potential VPPA contract can also unravel because the seller is ultimately unable to deliver. For example, a renewable energy project developer might be dependent on third parties to fund a project's construction. Yet, they may be unable to secure the finance needed. Some renewable energy developers prefer to focus on just the initial development of a solar plant or wind farm. In this case, the end goal for the developer is simply to sell the project "as is" to another company to construct and operate. Both of those scenarios introduce project risk, the possibility of delays, and a contract ultimately not being delivered.

Summary

While the sustainability strategy might be the domain of the sustainability group, implementing that strategy takes a much broader team. Many sustainability strategies include targets for reducing greenhouse gas emissions and everything that happens on the VPPA journey should be tightly connected to those targets in order to achieve the impact desired. But, there is one golden rule for a successful VPPA: Engage the CFO early, engage the CFO often.

The Budweiser Wind Farm at Thunder Ranch.

Want to learn more?

Contact the Enel Green Power Commercial Office at CommercialEGP@enel.com.

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